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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929

No. 250

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

OX FIBRE BRUSH COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 15, 1929
CERTIORARI GRANTED OCTOBER 21, 1929

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929

No. 250

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

OX FIBRE BRUSH COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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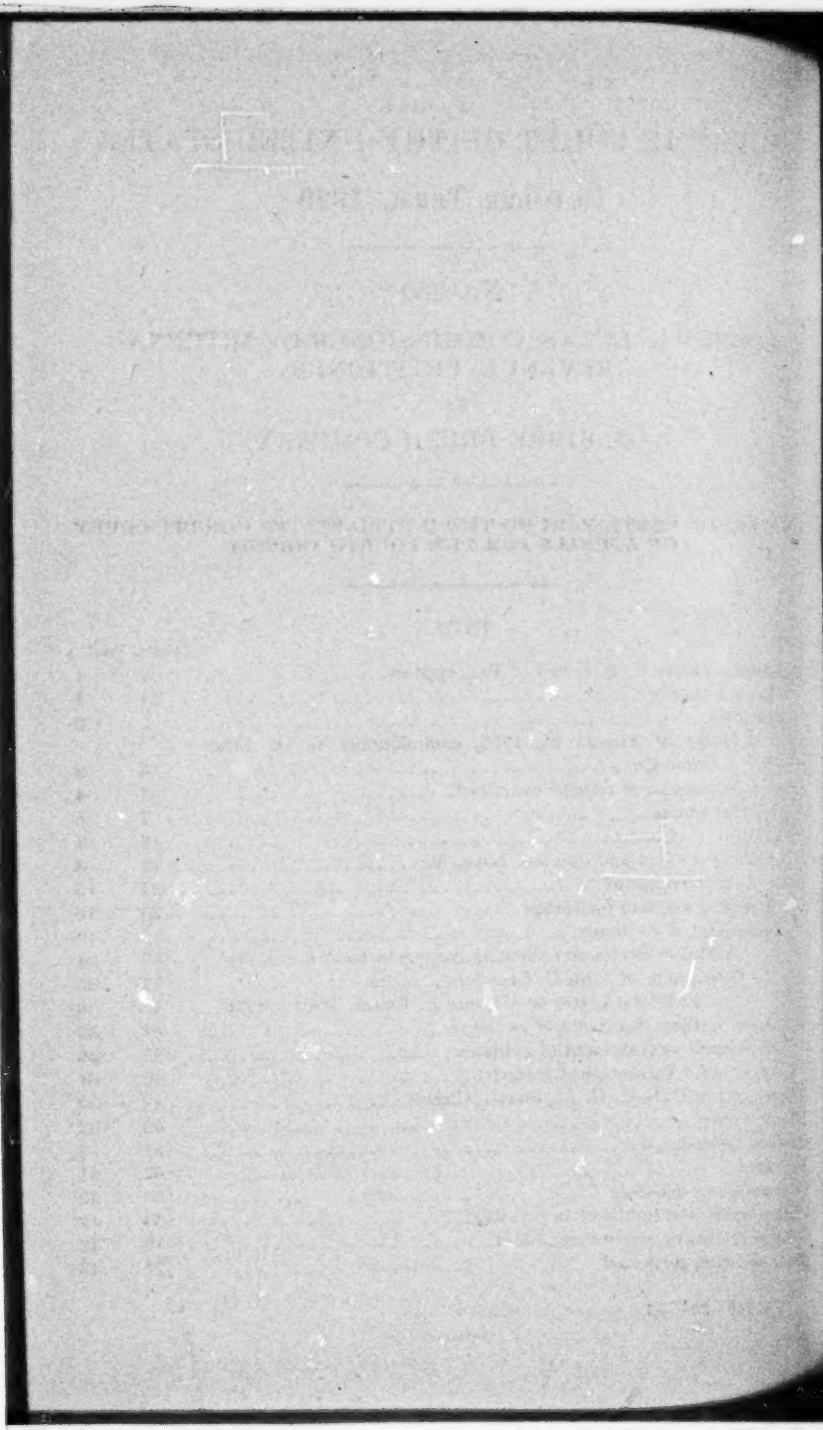

1 Before United States Board of Tax Appeals

Docket 8153

OX FIBRE BRUSH COMPANY, FREDERICK, MD., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

For the taxpayer, H. B. Sutter, Esq.; for the Comm'r, M. N. Fisher, Esq.

Docket Entries

1925

Oct. 16. Petition received & filed.
" 23. Copy of petition served on solicitor.
" 23. Notification of receipt mailed taxpayer.
Nov. 10. Answer filed by solicitor.
" 14. Copy of answer served on taxpayer. Assigned general calendar.

1926

Nov. 9. Hearing date set for 1-20-27.

1927

Jan. 20. Hearing had before Mr. Love on merits, Briefs due 2-24-27.
" 28. Transcript of hearing 1-20-27 filed.
Feb. 23. Brief filed by taxpayer.
" 24. " " " G. C.
Oct. 1. Finding of fact & opinion rendered (Love). Judgment will be entered for the Comm'r. Both sides notified.
" 1. Order of redetermination signed & filed. Both sides notified.
" 28. Motion for review & reconsideration filed by taxpayer.
Nov. 14. Ordered above motion denied. Both sides notified.

2 1928

Mar. 10. Supersedeas bond for $48,183.20 approved & ordered filed.
" 27. Agreement for review by U. S. Cir. Ct. of Ap., 4th Circuit, filed.
" 27. Petition for review with assignments of error filed by taxpayer.
" 27. Proof of service filed.
May 4. Amended petition for review filed by taxpayer.
" 4. Proof of service for filing petition for review filed by taxpayer.
" 12. Agreed praecipe filed.
" 12. " statement of evidence lodged.
" 14. " " " " approved & ordered filed.

Now, May 15, 1928, the foregoing docket entries certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Docket No. 8153

Appeal of Ox Fibre Brush Company, Frederick, Maryland.

Petition

Filed Oct. 16, 1925

The above-named taxpayer hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter (IT:CR:E–HE–6OD), dated August 25, 1925, and as the basis of its appeal sets forth the following:

1. The taxpayer is a West Virginia corporation with its principal office at Frederick, Maryland.

2. The deficiency letter (a copy of which is attached) was mailed to the taxpayer on August 25, 1925.

3 3. The taxes in controversy are income and profits taxes for the calendar year 1920 and are more than $10,000.

4. The determination of tax contained in said deficiency letter is based upon the following errors:

(a) The Commissioner of Internal Revenue erred in failing to allow as a deduction from gross income in computing taxable net income for the calendar year 1920, $24,000 of compensation accrued during that year to J. K. Robinson, jr., president, and $24,000 of compensation accrued during that year to A. McEwen, treasurer.

(b) The Commissioner of Internal Revenue erred in disallowing as a deduction from gross income in computing taxable net income for the year 1920, $24,000 accrued during that year as compensation to J. K. Robinson, jr., president, for services rendered, and $24,000 accrued during that year as compensation to A. McEwen, treasurer, for services rendered.

5. The facts upon which the taxpayer relies as the basis of its appeal are as follows:

During 1920, there was accrued and paid on the books of this taxpayer compensation to J. K. Robinson, jr., president, for services rendered in the amount of $36,000. The Commissioner of Internal Revenue disallowed as a deduction for 1920, $24,000 of the compensation accrued and paid to J. K. Robinson, jr., president, for his services. There was also accrued and paid on the books of the corporation for 1920, $39,000 to A. McEwen, treasurer, as compensation for services rendered by him. The Commissioner of Internal Revenue disallowed as a deduction for 1920, $24,000 of the compensation accrued and paid to A. McEwen for his services.

J. K. Robinson, jr., and A. McEwen, were, during 1920, the active managing officers of the company. They gave their time and attention to their duties as president and treasurer, respectively, of the company. The compensation paid these officers in 1920
4 for their services were reasonable, and was based upon the value of the services rendered to the corporation.

6. The taxpayer, in support of its appeal, relies upon the following propositions of law:

Section 234 (a) (1) of the Revenue Act of 1918 provides, in part, as follows:

"That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

"All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered * * *."

Wherefore, taxpayer respectfully prays that this board may hear and determine its appeal.

ALBERT L. HOPKINS,
HARRY B. SUTTER,
RICHARD S. DOYLE,
Counsel for Taxpayer,
110 South Dearborn Street, Chicago, Illinois.

Duly sworn to by J. K. Robinson, jr.; jurat omitted in printing.

5 TREASURY DEPARTMENT, WASHINGTON,

OFFICE OF COMMISSIONER OF INTERNAL REVENUE

Aug. 25, 1925.

IT:CR:E
HE:6OD

OX FIBRE BRUSH COMPANY,
Frederick, Maryland.

Sirs: A reexamination of your income-tax returns and additional data submitted at conference for the calendar year 1920 and 1921 discloses an additional tax due for 1920 amounting to $24,091.60 and an overassessment for the year 1921 amounting to $2,299.20, as shown in the attached statement and accompanying schedules.

In accordance with the provisions of section 274 of the revenue act of 1924, you are allowed 60 days from the date of mailing of this letter within which to file an appeal to the United States Board of Tax Appeals contesting in whole or in part the correctness of this determination.

Where a taxpayer has been given an opportunity to appeal to the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement respect of any part of the deficiency will be entertained.

If you acquiesce in this determination and do not desire to file an appeal, you are requested to sign the inclosed agreement consenting to the assessment of the deficiency and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:CR:E-HE-60D. In the event that you acquiesce in
6 a part of the determination, the agreement should be executed with respect to the items agreed to.

Respectfully,

D. H. BLAIR,
Commissioner,
By J. G. BRIGHT,
Deputy Commissioner.

Inclosures:
Statements
Agreement—Form A.
Schedule 1 to 15, incl.

IT:CR:E

STATEMENT OF RETURNS EXAMINED AND RESULTING TAX LIABILITY

Returns examined

Ox Fibre Company, Frederick, Maryland	1920	1120 cons.
	1921	1120 cons.
American Fibre Company, Jacksonville, Fla.	1920	Included
	1921	above.
Frederick Mfg. Company, Frederick, Md.	1920	Included
	1921	above.

Tax liability

Ox Fibre Brush Company:	Additional tax	Overassessed
Year 1920	$24,091.69	
1921	----------	$2,299.29
Net additional tax	$21,792.40	---------

The adjustments producing the above tax liability are contained in the attached Schedules 1 to 15, inclusive, based upon a revenue agent's report dated October 31, 1923, brief dated June 16,
7 1925, and supplement thereto dated July 16, 1925, and conference held in Washington, on July 9, 1925.

A certificate of overassessment for the amount shown above will be issued through the office of the Collector of Internal Revenue for your district and will be applied by that official in accordance with the provisions of section 281 (a) of the revenue act of 1924.

The right of appeal as set forth herein applies only to the year 1920, in which there is a deficiency in tax as defined by section 273 of the revenue act of 1924.

Year ended December 31, 1920

Schedule 1—Net income

Ox Fibre Brush Company:

Net income as disclosed by bureau May 25, 1925	$210,161.81
As corrected	206,753.67
Net deductions—Additional depreciation allowed	$3,408.14

Schedule 2—Explanation of items changed

(a) In accordance with conference decision, the depreciation rate on machinery, etc., is increased to 11-1/9% same as allowed for 1918 and 1919.

Cost, 1/1/1920	$297,093.77	
12/31/1920	316,372.53	
	$613,466.30	
Average, 306,733.15 @ 11-1/9%		$34,081.46
Allowed in bureau letter May 28, 1925		30,673.32
Additional depreciation allowed		$3,408.14

Schedule 3—Net income

American Fibre Company:

Net loss as disclosed by bureau letter May 25, 1925	$30,478.30
As corrected	No change.

Schedule 4—Consolidated net income 1920

Net income as corrected:		
Ox Fibre Brush Company	$206,753.67	
Net loss as corrected:		
American Fibre Company	30,478.30	
Total		$176,275.37

Schedule 5—Consolidated invested capital 1920

As shown in bureau letter May 25, 1925	$751,088.31
As corrected	No change.

Schedule 6—Excess-profits credit

No change	$68,083.06

Schedule 7—Computation of total tax 1920

Excess-profits tax	Income	Tax
Net income for taxable year (Schedule 4)	$176,275.37	
Less excess-profits credit	63,083.06	
Balance	$113,192.31	
Taxable at 20%, 150,207.66 less 63,083.06	87,124.60	$17,424.92
Taxable at 40%	26,067.71	10,427.08
		27,852.00

Income tax:			
Net income for taxable year		$176,275.37	
Less: Interest on obligations of United States not exempt	$332.50		
Excess profits tax	27,852.00		
Exemption	2,000.00		
		30,184.50	
Taxable at 10%		$146,090.87	$14,609.09
Total, excess-profits, and income taxes			$42,461.09
Previously assessed #402123			18,369.48
Additional tax to be assessed			$24,091.61

Schedule 8—Net income

Ox Fibre Brush Company:	
Net income as disclosed by bureau letter May 25, 1925	$128,690.72
As corrected	125,018.25
Net deductions—Additional depreciation allowed	$3,672.47

10 *Schedule 9—Explanation of items changed*

(a) See Schedule 2, computed for 1921 as follows:	
Cost machinery, Dec. 31, 1920	$316,372.53
Dec. 31, 1921	344,669.24
	661,041.77
Average, $330,520.89 @ 11-1/9%	$36,724.57
Allowed in bureau letter May 25, 1925	33,052.10
Additional depreciation allowed	$3,672.47

Schedule 10—Net income

American Fibre Company:	
Net loss as disclosed by bureau letter May 25, 1925	$5,128.45
As corrected	No change.

Schedule 11—Consolidated net income 1921

Net income as corrected, Ox Fibre Brush Company	$125,018.25
Net losses as corrected, American Fibre Company	5,128.45
Aggregate net income	$119,889.80

11 *Schedule 12—Consolidated invested capital 1921*

As shown in bureau letter dated May 25, 1925			$736,736.87
As corrected			733,991.33
Net decrease as explained below			$2,745.54
Increases:			
(a) Adjusted prorated 1920 tax		$662.60	
Decreases:			
(b) Additional depreciation allowed 1920		3,408.14	
Net decrease as above			$2,745.54

Schedule 13—Explanation of items changed

(a) The adjusted 1920 tax as shown in Schedule 7 of this letter is prorated out of invested capital, as follows:

1920 tax prorated in letter dated May 25, 1925	$18,606.59
Corrected 1920 tax $42,461.09 prorated (.4226)	17,943.99
Excess is restored	$662.60

(b) Additional allowance for depreciation is a reduction of surplus as at December 13, 1920.

12 *Schedule 14—Computation of excess profits credit*

Consolidated net income taxable year (Schedule 11)	$119,889.80
Consolidated invested capital taxable year (Schedule 12)	$733,991.33
Excess profits credit:	
8% of invested capital for taxable year	$58,719.31
Exemption	3,000.00
Excess-profits credit	$61,719.31

Schedule 15—Computation of total tax 1921

Excess-profits tax	Income		Tax
Net income for taxable year	$119,889.80		
Less excess-profits credit	61,719.31		
Balance	$58,170.49		
Taxable at 20%			$11,634.10
Income tax:			
Net income for taxable year	$119,889.80		
Less:			
Interest on obligations of United States not exempt	$332.50		
Excess-profits tax	11,634.10	11,966.60	
Taxable at 10%	$107,923.20		10,792.32
13 Total, excess-profits and income taxes			$22,426.42
Previously assessed $400,720			24,725.62
Overassessed			$2,299.20

Now, May 15, 1928, the foregoing petition certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Docket No. 8153

Appeal of Ox Fibre Brush Company, Frederick, Maryland

Answer

Filed Nov. 10, 1925

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, Solicitor of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraphs 1, 2, and 3 of the petition.

(2) Denies that any error was made in the determination of the deficiency in tax set out in the letter of August 25, 1925.

(3) Admits that the commissioner disallowed $24,000 of the salary to J. K. Robinson, jr., and $24,000 of the salary to A. McEwen in the year 1920.

(4) Admits that in that year J. K. Robinson, jr., and A. McEwen were respectively president and treasurer of the taxpayer corporation and that they performed the duties of those offices.

(5) Denies that the compensation paid to the aforesaid officers in 1920 is reasonable and based upon the value of the services rendered to the taxpayer.

(6) Denies, generally, and specifically, each and every allegation in the taxpayer's petition contained not hereinbefore admitted, qualified, or denied.

Under the provisions of section 234 (a) (1) of the revenue act of 1918 the deduction on account of salaries paid to officers of a corporation is limited to a reasonable allowance for the services actually rendered.

Wherefore it is prayed that the taxpayer's appeal be denied.

A. W. GREGG,
Solicitor of Internal Revenue,
Attorney for Commissioner of Internal Revenue.

Of counsel:

M. N. FISHER,
Special Attorney, Bureau of Internal Revenue.

[Certificate to foregoing paper omitted in printing.]

Before United States Board of Tax Appeals

OX FIBRE BRUSH COMPANY, PETITIONER v. COMMISSIONER OF INTERNAL REVENUE, respondent	Docket No. 8153. Promulgated October 1, 1927.

Findings of fact and opinion

Additional compensation in the amount of $48,000 voted and accrued by the petitioner in May, 1920, to its president and treasurer was in excess of reasonable compensation for personal services actually rendered in that year.

Harry B. Sutter, Esq., for the petitioner; W. N. Fisher, Esq., for the respondent.

This proceeding is for the redetermination of a deficiency in income and profits taxes for the calendar year 1920 in the amount of $24,091.60. The entire amount of the deficiency is not in dispute but only so much thereof as arises from the disallowance by the commissioner of the additional salaries paid by the petitioner to its

president and treasurer in that year and deducted from gross income as ordinary and necessary business expenses.

Findings of fact

The petitioner is a corporation organized under the laws of the State of West Virginia. It was, during the year 1920 and for many years prior thereto, engaged in the manufacture of brushes. Its factory is located at Frederick, Maryland. Its executive offices and principal sales headquarters are located in New York City. The petitioner also has branch sales offices at St. Louis, Cincinnati, Philadelphia, and Boston.

J. K. Robinson, jr., was petitioner's president during the year 1920 and had been its president since 1905 or 1906. Alfred McEwen joined the petitioner in 1907, became its treasurer at that time and continued in that office through the year 1920. Both the president and treasurer of the petitioner from 1907 until and including 1920, devoted their entire time to the promotion of its interests. During the year 1920 and in years prior and subsequent thereto they lived in or near New York City and performed their duties primarily at the executive offices located there.

In the year 1907, when Robinson and McEwen assumed control of the petitioner, the factory was in a chaotic state and was operating at a loss. In a large measure due to their efforts, the petitioner progressed to a foremost position in the brush trade and was frequently importuned by competitors to buy them out or combine with them.

16 Prior to the year 1917 a technical expert managed the petitioner's factory, for which he received $10,000 per annum. In the year 1917 Robinson and McEwen took over the general management of the factory. The services of the technical expert were dispensed with, and in his place a factory superintendent was employed at a much lower salary to supervise routine work. In addition to their regular executive duties the president and treasurer handled all large purchases, directed all sales, directed the hiring of personnel, and directed the policies of the petitioner and lines of factory development. These services were rendered from 1917 until and including 1920.

During the early part of the year 1920 the petitioner was negotiating with two large brush-manufacturing concerns relative to purchasing those concerns. These negotiations were dropped in April, 1920, but while pending they necessitated on the part of Robinson and McEwen considerable traveling, visiting of plants, and work pertaining to the possible reorganization thereof. The plants, the purchase of which was under consideration, subsequently failed.

In addition to the annual salaries of $12,000 and $15,000 paid, respectively, to the president and treasurer, the board of directors at a meeting held on May 6, 1920, pursuant to notice to all directors, unanimously voted to pay each of these officers additional compensation of $24,000. The minutes of the meeting, so far as pertinent here, are as follows:

* * * * * * *

"This meeting having been specially called for the purpose of considering and acting upon the proposal for a grant of additional compensation to Mr. J. K. Robinson, jr., and to Mr. Alfred McEwen, for their past services to the company, * * *

"Resolved that this board hereby authorize and direct the payment of the sum of twenty-four thousand ($24,000) dollars to Mr. J. K. Robinson, jr., as extra compensation for his past services to this company, as an officer thereof and in any other capacity, the same to be paid when, in the discretion of the officers, funds of this corporation for this purpose are available.

17 "Resolved that this Board authorizes and directs the payment of the sum of twenty-four thousand ($24,000) dollars, to Mr. Alfred McEwen as extra compensation for his past services to this company as an officer thereof and in any other capacity, the same to be paid when in the discretion of the officers, funds of this corporation for this purpose are available."

* * * * * * *

The petitioner's books were kept on the accrual basis, and in May, 1920, proper entry was made therein by crediting the accounts of the president and treasurer with the additional compensation voted and charging the expense accounts therewith.

The total compensation of $56,000 and $39,000 for the president and the treasurer, respectively, accrued and paid in the year 1920, was voted by the board of directors, having regard for the past services rendered by these officers, for the fact that they had to live in New York City, and as a reward for good efforts given to the business as demonstrated by the results accomplished.

The directors of the petitioner were J. K. Robinson, jr., Alfred McEwen, John G. Crawford, a former vice president who was originally employed and brought into the business by McEwen, and Emory L. Coblentz, a banker of Frederick, Maryland, with whom the petitioner transacted a large part of its banking business. J. K. Robinson, jr., and Alfred McEwen and their families owned approximately 36 per cent of the stock of the petitioner. Of the remaining outstanding stock of the petitioner a portion was owned by employees and a portion by Robinson's mother and sister.

Officers' salaries, gross sales, amounts carried to surplus after deducting officers' salaries and other expenses, dividends declared and paid, and the amount of capital stock outstanding for the years 1908 to 1914, inclusive, and 1918 to 1922, inclusive, were as follows:

	Officers' salaries	Gross sales	Net earnings—Amount carried to surplus	Dividends declared and paid	Outstanding capital stock
	$6,000.00	Not shown.	$3,972.44	None.	$300,000.00
	6,000.00	$374,236.66	41,985.36	None.	275,000.00
	9,999.00	467,943.50	68,009.99	$8,686.50	286,600.00
	9,999.00	521,650.78	21,611.75	4,500.00	298,600.00
	9,999.00	596,910.57	52,013.74	4,500.00	300,000.00
	10,999.00	612,087.57	49,810.44	13,387.50	297,500.00
	16,000.00	596,856.83	18,591.95	4,462.50	297,500.00
data furnished for 1918 to 1917.)					
	25,384.64	1,068,641.46	152,679.16	56,576.00	465,400.00
	27,000.00	1,193,742.39	211,130.52	133,579.50	474,700.00
	75,000.00	1,273,474.72	152,753.67	(125,275.00 800,000.00	Cash. Stock.
	27,000.00	980,376.56	128,745.07	94,388.00	899,000.00
	33,000.00	1,342,834.03	255,762.16	170,860.00	900,000.00

The regular, additional, and total salaries paid or accrued to the titioner's president and treasurer in the year 1920 were not in oportion to the number of shares of stock held by them.

In computing the petitioner's taxable income for the year 1920 e commissioner disallowed as a deduction the additional compensa- n of $48,000 voted and accrued in 1920 to the president and asurer under the circumstances above set forth.

Opinion

Love: The sole issue in this proceeding is whether the additional npensation in the amount of $48,000 voted and accrued in the year 0, pursuant to the action taken by the board of directors on May 1920, to the petitioner's president and treasurer may be deducted m gross income for that year.

It is necessary, first, for us to determine the status of the additional npensation in question. Was it voted as and for salaries for 1920, hough measured by services rendered prior to that year, or was it ed and accrued in 1920 as and for salaries for services performed prior years? If the additional compensation comes within the ter classification, then, in our opinion, it may not be deducted the year 1920. Appeal of Vaughan & Barnes, Inc., 6 B. T. A. 1279.

The resolution of May 6, 1920, is ambiguous and might be susceptible to either interpretation. The resolution, in part, s:

This meeting having been called for the purpose of considering l acting upon the proposal for a grant of additional compensation Mr. J. K. Robinson, jr., and Mr. Alfred McEwen for their past vices to the company * * *"

t the hearing the history of the petitioner was opened up and dence was introduced with respect to the action taken by the rd of directors and of their intention in connection therewith.

We have held in the Appeal of Union Dry Goods Co., 1 B. T. A. 833, that the minute as written is not conclusive as to the year for which additional compensation was authorized. From all of the evidence adduced, we are of the opinion that the additional compensation voted and accrued in May, 1920, was intended to be as and for, and was as and for salaries for the year 1920. The motivating or impelling influence, however, in determining the amount to be paid as additional compensation for the year 1920 was the services rendered by the officers in question prior to that year. In other words, the additional compensation for 1920 was based upon efficiency and ability of the officers as demonstrated by past performances and results achieved over the preceding period of years.

Section 234 (a) (1) which provides for the deduction of salaries reads, in part, as follows:

"(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered * * *."

It follows, therefore, that if the regular annual salaries of the petitioner's president and treasurer plus the additional salaries of $48,000 constituted reasonable compensation for services actually rendered by those officers in 1920, the deduction on account thereof is properly allowable. The petitioner urges that the total
20 compensation for 1920 was reasonable in amount for services actually rendered in that year by the officers in question, and the respondent insists that it was unreasonable.

In support of its contention that such amount was reasonable compensation for 1920, the petitioner takes the position that the action of the board of directors of a corporation in authorizing salaries for a given year raises a presumption that the amount voted is reasonable and complies with the statute until the contrary be proven. In other words, the petitioner insists that the burden of proof is on the respondent to show that the salaries for 1920 were unreasonable. We are unable to agree with the petitioner in this respect.

Our attention is called to the case of United States v. Philadelphia Knitting Mills Co., 273 Fed. 657, as supporting the petitioner's position that the compensation in dispute is presumed to be reasonable until the presumption is overcome. In that case the court was construing the corporation excise tax act of 1909, which provided for a tax at a named rate upon the net income of a corporation to be ascertained by deducting from its gross income "all ordinary and necessary expenses." The statute did not specifically make salary an allowable deduction, though it was so construed by the Bureau of Internal Revenue when the salary is a "reasonable and fair compensation for services rendered regardless of the amount of stock such officer may hold." The court in holding that, under the statute, the Government may not determine whether salary paid corporation

officers is a reasonable and fair compensation, but may determine whether it is salary that is paid or whether it constitutes profits diverted to a stockholding officer under the guise of salary, stated:

"Confining our inquiry to the statute, it appears that the basis on which a salary may be allowed as a valid deduction is that it was in fact an 'ordinary and necessary expense (of the corporation) actually paid * * * in the maintenance and operation of its business.' To be a necessary expense it must have been paid for services actually rendered. Jacobs & Davies, Inc., Anderson, 288 Fed. 505, 506, 143 C. C. A. 87. Whether services were rendered and whether also they were commensurate with the salary paid are
21 matters of judgment and discretion reposed by general law in the board of directors of the corporation. As the board of directors is charged with the duty and clothed with the discretion of fixing salaries of the corporation's officers, the Government has no right (until expressly granted by statute) to inquire into and determine whether the amounts thereof are proper—that is, whether they are too much or too little. But while the amount of salary fixed by a board of directors is presumptively valid, it is not conclusively so, because the Government may inquire whether the amount paid is salary or something else. Admittedly the Government has a right to collect taxes on net income of a corporation based on profits after all ordinary and necessary expenses, including salaries, are paid. It has a right, therefore, to attack the action of a board of directors and show by evidence, not that a given salary is too much, but that, in the circumstances the whole or some part of it is not salary at all but is profits diverted to a stockholding officer under the guise of salary and as such is subject to taxation * * *. The question of fact here was whether the money paid was all salary or part profits. *The presumption arising from the action of the board of directors was that it was all salary.* In order to overcome the presumption the burden was on the Government to produce evidence, not necessarily conclusive, but sufficient to raise a valid inference that some definite part of the compensation was not salary but profits. (Emphasis supplied.)

It is apparent from the foregoing statement that the court was not considering the reasonableness of the compensation sought to be deducted. The only question before it was whether the amount sought to be deducted was in fact salary, and with respect to the amount fixed as salaries the court stated that there was a presumption that it was in fact all salary. That is simply another way of saying that the acts of the board of directors of a corporation are presumed to be regular and valid.

The revenue act of 1918 differs from the corporation excise tax act of 1909 with respect to the deduction of salaries, in that section
22 234 (a) (1) supra specifically provides for a deduction for "a reasonable allowance for salaries or other compensation for personal services actually rendered." Pursuant to this pro-

vision, as stated in the case of William S. Gray & Company v. United States, decided by the Court of Claims June 6, 1927, "it is undoubtedly the right, as well as the duty, of the Commissioner of Internal Revenue under the provisions of the 1918 revenue act to determine the reasonableness of the salaries of which a deduction is asked by the taxpayer, as well as to decide whether or not the salaries are ordinary and necessary expenses in the maintenance and operation of the business."

In the Appeal of Gustafson Manufacturing Company, 1 B. T. A. 508, we stated:

"Counsel for taxpayer contends that the directors of the corporation are the sole judges as to what constitutes reasonable compensation, and that since they determined upon $20,000 as a salary to be paid the president and general manager for 1918 the commissioner has no authority to reduce the amount notwithstanding the fact that the salary was based upon earnings or was a distribution of profits of the corporation in the form of compensation. This contention, of course, can not be sustained."

* * * * * * *

"Under the provision of this section (234 (a) (1) supra) the commissioner not only has the authority but it is his duty to determine under all of the facts obtainable the reasonableness or unreasonableness of deductions by a corporate taxpayer of compensation paid. The commissioner, upon the evidence before him, determined that a deduction of $16,000 for compensation for the services rendered taxpayer by its president and general manager during the year 1918 was reasonable. The evidence before us does not justify a deduction for compensation of an amount in excess of that determined by the commissioner."

In The W. K. Henderson Iron Works & Supply Co. v. Commissioner of Internal Revenue, 6 B. T. A. 92, we stated in part:

23 "* * * It may be that such additional salaries paid in 1919, when added to the regular salaries paid in 1919, constitute a reasonable compensation for personal services actually rendered in that year, but we have no evidence before us concerning the salaries paid, service performed, or the volume or character of business done during the year 1919, and we are, accordingly, without the necessary facts to determine the issue for that year."

We conclude, therefore, that the action taken by the board of directors in voting the total compensation to the officers in question for 1920 does not raise a presumption that the amount voted was in fact reasonable for services actually rendered, thereby complying with the terms of the statute. The commissioner having determined that the additional compensation voted in May, 1920, was unreasonable for services actually rendered in that year, it becomes necessary for the petitioner, if the deduction is to be allowed, to show that he erred in his determination. We therefore, must be guided

in our determination as to the reasonableness of the compensation in dispute by the evidence adduced in this proceeding.

It will be noted from the table set out in the findings of fact that the petitioner was prosperous in years prior to 1920. It will also be noted that the compensation for 1920 to the officers in question was more than two times the amount received in any other year. There is nothing in the record to indicate that additional salaries might be expected or would be granted in the future, and there is nothing to indicate that the duties performed were materially different from those performed in preceding or succeeding years. It is not intimated that the compensation received prior to and subsequent to 1920 was inadequate. Under these circumstances we are of the opinion that the salaries paid by the petitioner to its officers in years prior to and subsequent to 1920 is the best evidence of their reasonableness and their value to the petitioner in that year. The deliberate, bona fide action of the board of directors over a period of years is persuasive in such matters.

It may be conceded that the officers in question were
24 efficient and brought prosperity to the petitioner and that the additional compensation was a merited recognition on the part of the board of directors of the valuable services rendered prior to 1920, but all of the evidence tends to the conclusion that the extra compensation for 1920 was in excess of reasonable compensation for services performed in that year.

We approve, therefore, the respondent's determination in disallowing as a deduction for the year 1920 the additional salaries in the amount of $48,000.

Judgment will be entered for the respondent.

Considered by Smith and Littleton.

[Certificate to foregoing paper omitted in printing.]

Before United States Board of Tax Appeals, Washington

Ox Fibre Brush Company, petitioner vs. Commissioner of Internal Revenue, respondent	Docket No. 8183

Order of redetermination

Pursuant to the Board's findings of fact and opinion, promulgated October 1, 1927, it is

Ordered and decided that, upon redetermination, there is a deficiency for the year 1920 in the amount of $24,091.60.

(Signed) William D. Love,
Member United States Board of Tax Appeals.

Dated Washington, D. C., October 1, 1927.

25 [Certificate to foregoing paper omitted in printing.]

Before United States Board of Tax Appeals

OX FIBRE BRUSH COMPANY, PETITIONER
vs.
DAVID H. BLAIR, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT
} Docket No. 8153

Amended petition for review

Filed May 4, 1928

To the honorable the Judges of the United States Circuit Court of Appeals for the Fourth Circuit:

Your petitioner, Ox Fibre Brush Company, respectfully shows:

I

Jurisdiction for review

This is a proceeding for review by the United States Circuit Court of Appeals for the Fourth Circuit of a decision of the United States Board of Tax Appeals, entered on the first day of October, 1927, and redetermining a deficiency in income and excess profits taxes for the calendar year 1920 against your petitioner in the amount of $24,091.60.

II

Your petitioner is a corporation organized under the laws of the State of West Virginia, with its factory located at Frederick, Maryland, and its executive offices and principal sales headquarters in New York City.

31 Your petitioner made its income and excess-profits tax return for the year 1920 to the collector of internal revenue at Baltimore, Maryland.

III

Nature of controversy

The nature of the controversy before the United States Board of Tax Appeals concerned the propriety of the disallowance as a deduction, in the determination of the taxable net income, of certain compensation voted and paid by your petitioner to certain of its officers in 1920, as follows:

During 1920 your petitioner voted and paid $39,000.00 as compensation for the services of its president, and during the same year voted and paid $36,000.00 to its treasurer as compensation for his

services. On its income and profits tax return for the calendar year 1920 your petitioner deducted the total of these payments, $75,000.00, in computing taxable net income. The Commissioner of Internal Revenue disallowed as a deduction to your petitioner $24,000.00 out of the salary paid to the president and $24,000.00 out of the salary paid to the treasurer, total $48,000.00, and fixed a salary of $15,000.00 for the president and $12,000.00 for the treasurer as the reasonable compensation for the services of these officers.

IV

Assignments of error

The Board of Tax Appeals approved the aforementioned action of the Commission of Internal Revenue, and in so doing submitted the following errors, upon which the petitioner relies as the basis of this proceeding:

1. The United States Board of Tax Appeals erred in failing to find that a salary of $39,000.00 for the president of your petitioner and a salary of $36,000.00 for the treasurer of your petitioner, voted and paid in 1920 as compensation for services, were reasonable and deductible in computing the taxable net income of your petitioner for the calendar year 1920, though such finding was amply supported by evidence.

2. The United States Board of Tax Appeals erred in finding that a salary of $15,000.00 for the president of your petitioner and a salary of $12,000.00 for the treasurer of your petitioner were reasonable compensation for the services of these officers rendered to your petitioner for the calendar year 1920, there being no evidence in the record to support any such finding.

3. The United States Board of Tax Appeals erred in excluding from evidence on behalf of petitioner a statement of loans by banks, from 1908 to 1921, inclusive, personally guaranteed by the president and treasurer of petitioner.

4. The United States Board of Tax Appeals erred in failing to find upon the evidence that the duties performed by the president and treasurer, respectively, of your petitioner during the calendar year 1920 were materially different from the services performed by these officers in the preceding and succeeding years, and that, consequently, evidence of compensation voted and paid to these officers for those years was immaterial and irrelevant and should be given no weight whatever.

5. The United States Board of Tax Appeals erred in finding that the duties performed by the president and treasurer, respectively, of your petitioner during the calendar year 1920 were not materially different from the services performed by these officers in the preceding and succeeding years, there being no evidence to support such finding.

6. The United States Board of Tax Appeals erred in failing to find that the compensation paid the president and treasurer, respectively, of your petitioner for services rendered prior and subsequent to 1920 was inadequate, there being ample evidence to support such a finding.

28 7. The United States Board of Tax Appeals erred in excluding evidence offered by petitioner tending to show that there was discussion in prior years relevant and relating to the inadequacy of compensation then paid to the president and treasurer.

8. The United States Board of Tax Appeals erred in failing to find that the compensation paid the president and treasurer, respectively, of your petitioner prior to 1920 was inadequate, there being ample evidence to support such a finding.

9. The United States Board of Tax Appeals erred in giving any weight whatever to evidence of compensation paid in the years preceding and succeeding the year 1920 without affirmative evidence that the conditions existing in those years were the same, and that the compensation paid was inadequate, there being ample evidence that conditions were different and the compensation paid was inadequate.

10. The United States Board of Tax Appeals erred in holding that the burden of proof was on your petitioner to establish that the compensation voted and paid its president and treasurer in 1920 was reasonable merely because of the contrary determination by the Commissioner of Internal Revenue.

11. The United States Board of Tax Appeals erred in failing to hold that the formal action taken by the board of directors of your petitioner in voting compensation for services to its president and treasurer for the year 1920 raised a presumption in fact and in law that the amounts, respectively, voted were reasonable for the services rendered by such officers.

12. The United States Board of Tax Appeals erred in holding that the formal action taken by the board of directors of your petitioner in voting compensation for services to its president and treasurer for the year 1920 did not raise a presumption that the amounts, respectively, voted were reasonable for the services rendered by such officers.

13. The United States Board of Tax Appeals erred in its conclusions of law.

29 14. The determination of ultimate facts by the United States Board of Tax Appeals is not reasonably supported by facts and is contrary to the weight of the evidence.

Wherefore your petitioner prays that this court may review the determination of the Board of Tax Appeals in this cause, reverse the decision of the board, and direct said board to allow a deduction of $75,000.00 as compensation for services of your petitioner's president and treasurer in 1920 in computing your petitioner's tax-

the net income for that year, and/or other and further relief as may to this court appear proper in the premises.

RICHARD S. DOYLE,
CHARLES D. HAMEL,
HARRY B. SUTTER,
JOHN ENRIETTO,
Attorneys for Petitioner,
906 Southern Building, Washington, D. C.

[Duly sworn to by Richard S. Doyle; jurat omitted in printing.]

[Certificate to foregoing paper omitted in printing.]

Before United States Board of Tax Appeals

OX FIBRE BRUSH COMPANY, PETITIONER v. DAVID H. BLAIR, COMMISSIONER OF INTERNAL REVENUE, respondent	Docket No. 8153

Statement of evidence

Lodged May 12, 1928; filed May 14, 1928

The above-entitled cause came on for hearing before the Honorable William D. Love, member of the United States Board of Tax Appeals, on the 20th day of January, 1927, there being present the petitioner, by its counsel, Harry B. Sutter, and the respondent, by his counsel, M. N. Fisher.

Whereupon, the petitioner, to maintain the issues on its behalf, introduced the testimony of Emory L. Coblentz, Frank M. Dertzbaugh, John G. Crawford, and Alfred McEwen, together with certain exhibits as follows:

Ox Fibre Brush Company is a corporation organized under the laws of the State of West Virginia. The executive offices, whence emanated the policies of management of the company and where quite a sales headquarters was maintained, were located in New York. At Frederick, Maryland, administrative offices only, such as those necessary to conduct the factory and clerical equipment were maintained. At Frederick all the articles sold by the company were manufactured.

Alfred McEwen is president and treasurer of the Ox Fibre Brush Company and resides at Tarrytown, New York. He has been president for about a year, and entered the empl'y of Ox Fibre Brush Company in November, 1907. Prior thereto he had been employed by the Western Electric Company. Beginning with the year 1888, he went through their shops from the machinists' trade up to installing electrical machinery. The electrical

science was just developing with the company at that time, and there was very little in the way of electrical appliances, except the electrical bell and burglar alarms. Mr. McEwen went through their factory and its different branches, and when he left there in 1907, after having been there about 20 years, he was in charge of the machinery sales of the Chicago department. He left the Western Electric Company to join the Ox Fibre Brush Company in 1907.

Ox Fibre Brush Company was started and owned by Mr. Alfred McEwen's father-in-law, J. K. Robinson, sr. When Mr. McEwen married, Mr. Robinson, sr., suggested that he go to Frederick and see what he could do with the Ox Fibre Brush Company, which was a constant nuisance and a source of expense to Mr. Robinson. At that time, Mr. Robinson's son, J. K. Robinson, jr., was president of the company. He had preceded Mr. McEwen to Frederick by about two years. He was a much younger man than Mr. McEwen, had never had any factory experience, and had found a problem that he could not exactly cope with. His father concluded he needed some help, so he called on Mr. McEwen to help him, and when Mr. McEwen went there the two men joined forces in putting the plant into shape. Mr. McEwen did not become treasurer until much later.

The period was the formative period in the brush business in this country. At that time the largest manufacturers of brushes in the country were those who manufactured them on contract prison labor and the brushes were made in the various prisons of the country, referring now to the type of brush the Ox Fibre Brush Company makes—i. e., the common scrub brush and coarse brushes. Manufacturing could not continue under the conditions existing at that time. A large quantity of the brushes made were made in homes, the manufacture of a brush being a very simple hand operation. The trade was handed down from father to son, and they would make these brushes in the basements of their
32 homes and go out from house to house and sell them. There was very little modern business carried on in the brush industry. Altogether it was an unsatisfactory business, and no profit was made in the industry, and there was very little attempt made to build it up into a high-grade business at that time.

In 1907 the Ox Fibre Brush Company consisted of a fairly small factory that had been run in a haphazard manner and very badly managed, with no system of accounting. They had a bookkeeper who kept the cash balance by taking change from his pocket and putting change back in the till whenever he wanted to even things up. The natives of the town used to go into the factory, pick out a brush that they wanted, take it out, and it was a constant sink hole. So by that time Mr. Robinson had somewhere around $200,000 in cash put into it and nothing had ever been taken out, and there was no chance of taking anything out. The company had experimented with a female sales organization. They employed many

women to go around to the retail trade and solicit orders, which in turn were handed on to the jobber, and in turn they brought them to the factory. It left a bad odor throughout the country that took years to get rid of. The company had one office in Chicago, where it did a fair jobbing business.

Ox Fibre Brush Company never employed prison labor, and it was not in a position to compete with concerns using contract prison labor in the manufacture of brushes.

After Mr. McEwen had been in Frederick for a few months he discovered that the shop was not what it should be in many ways, and persuaded Mr. Robinson that, although they would have to pay a higher salary than they were giving at the time for a man, in order to get a high-grade shop man who could take that factory and place it on a proper manufacturing basis and keep it in the line of development to enable them to go ahead with the sale of brushes and develop a sales organization at the same time, to handle the increased product the shop might turn out, they should do so. Mr. Robinson agreed to that, and the result was that Mr. McEwen referred to his old friend Crawford, who had been associated with him for a great many years. Knowing his ability, Mr. McEwen wired him and asked him if he would consider such a proposition.

33 The officers employed a higher grade of salesmen and opened five branch offices in different parts of the country in which these salesmen were located to cover the adjoining territory, at St. Louis, Cincinnati, Philadelphia, New York and Boston. The officers also developed a line of advertising. The company at the time was putting out a sort of comic valentine in which negro characters were depicted using scrubbing brushes. The officers toned that up and produced a catalogue which was a revolution in the trade of scrub brush manufacturers and manufacturers of brushes similar to those of the Ox Fibre Brush Company. In other words, they gave to the trade somewhat of an education in the product they were making.

Mr. McEwen and Mr. Robinson, jr., worked all these things out and were practically like one organization. They worked in perfect harmony, and everything that was attempted was carried out in perfect accord. If one originated an idea, the other was willing to carry it out. It took some little time to get things going well, but after the start things went along famously.

J. K. Robinson, jr., president of the company, went to New York about a year after Mr. McEwen arrived in Frederick, so Mr. McEwen took charge of the factory from that time on until Mr. Crawford came with the company.

Mr. McEwen went to New York in 1911 or 1912 and has been there ever since, but it is his practice to continue to make frequent visits to the plant in Frederick.

John G. Crawford, referred to above, resides at Saunderstown, Rhode Island. He is and has been a clergyman of the Protestant

Episcopal Church for approximately five years, and has a parish at the present time in Rhode Island, including the towns of Wakefield, Saunderstown, and the mission of Shannock. Mr. Crawford is now the vice president and has been a director of the Ox Fibre Brush Company since 1914. His connection with the Ox Fibre Brush Company began in 1912. When Mr. Crawford was traveling in Europe, he received three cablegrams from Alfred McEwen, treasurer, offering him a position with the Ox Fibre Brush Company. Both men had worked together at the same time with the Western Electric Company at Chicago, Illinois. Mr. Crawford had
34 been first head draftsman and bookkeeper, and head draftsman at their factory at Anderson and was in charge of their Hawthorne shops. With the exception of one or two companies, Mr. Crawford had worked for all of the large electrical companies in the country—The Thompson-Hughes Company, the General Electric Company, the Westinghouse Electric Manufacturing Company, and the Simmons Company. In the drafting room of the Western Electric Mr. Crawford had direct supervision over about 400 draftsmen. In the Hawthorne shops he had direct supervision over 6,000 or 7,000 employees.

Mr. Crawford received his academic training in engineering at the Royal College of Science in Dublin, Ireland.

Mr. McEwen was employed with the General Electric Company as sales manager in charge of the local machinery sales at the same time that Mr. Crawford was with that company.

In 1912 Mr. Crawford took the position of factory manager at Frederick, Maryland, of the Ox Fibre Brush Company. When Mr. Crawford accepted employment with the corporation, the factory was in a chaotic state; it was operating very inefficiently, the company was not making much, if any, money, and the purpose for which Mr. Crawford was hired was to put the factory on a modern manufacturing basis, to see that the proper help were hired and the necessary machinery secured, and if any were designed to attend to that; and that up-to-date methods were installed to take effect in increased production and profits. To accomplish these things, Mr. Crawford revised the personnel of the factory where it was necessary to do so, altered the manufacturing methods where is was deemed advisable, and initiated and helped in the designing of special machinery relating to the manufacturing of the brushes. Mr. Crawford also altered the routing of the work through the factory to cut out lost motion and, in general, put the factory on a manufacturing basis. He saw that the basic rates of payment to the help were legitimate from the point of view of the company and also from theirs. The number of employees at that time was about 300, though it varied from time to time. The mechanical improvements consisted in evolving and installing machines which
35 were efficient and which would minimize the lost time spent for repairs and cut down the manufacturing cost. The output of the factory was very largely increased, but, of course, that took time.

Mr. McEwen and Mr. Robinson both made suggestions in these changes and approved practically all of them. In a word, they held the reins and issued orders, and Mr. Crawford would carry them out in the large items; but in the actual running of the factory, he did not disturb them with questions; that was his business.

Mr. Crawford left the employ of the Ox Fibre Brush Company in 1917. At that time, as factory manager, he was receiving a salary of $10,000 a year. After he left, the Ox Fibre Brush Company hired a man at a much lower salary than Mr. Crawford was getting. He was hired only as factory superintendent, not as factory manager. Mr. Crawford's duties after his departure were divided between Mr. McEwen in the New York office and Mr. Dertzbaugh in the factory. The shop was then in such a condition that Mr. McEwen could assume that management with a much smaller calibre man in the shop to look after the routine methods, so that the officers practically took over the general policy of shop management themselves and had a superintendent there to carry out their ideas. After Mr. Crawford left the company in 1917, he kept in touch with the affairs of the company on the average of once in six or eight weeks, either in the factory or in the New York office.

Mr. Robinson, sr., early decided that he would not advance any further funds to the business; that the officers should make it stand on its own bottom. They were confronted with the proposition of going to the banks and establishing a line of credit and had a great deal of trouble in getting it, but being a Frederick institution, and since it employed the maximum amount of labor that was employed in the town, the banks finally agreed to let the officers have a small line of credit, but the officers always had to endorse the paper personally.

Along about 1912 or 1913 the company had reached the limit of credit, and the two local banks would not extend any further credit. Since they were the only local source of supply, the officers went to New York and tried to borrow in New York, but they were
36 asked why they did not borrow at home. So Mr. Robinson, jr., and Mr. McEwen both advanced funds on their own credit.

Mr. Frank Dertzbaugh, as manager of the company, had charge of the company's banking arrangements in Frederick, Maryland. When he saw the need of money, and it was not forthcoming from the regular course of business, he sent a blank note to the New York executive officers, and they signed the same for the amount suggested as necessary, and invariably they signed it as officers of the company and endorsed it personally and returned it to Mr. Dertzbaugh, who thereupon deposited it to the company's credit at the bank, for the bank had made a rule that in order to pass by its board of directors, before credit would be extended, the paper would have to be endorsed personally by both Mr. McEwen and Mr. Robinson, who were men of large means and whose endorsements were

considered ample collateral for the company's loans. That arrangement continued up to recent date.

Counsel for petitioner then offered in evidence a statement showing the corporate bank loans personally guaranteed by J. K. Robinson, jr., president, and Alfred McEwen, treasurer, during the period 1908 to 1921, inclusive, which statement had previously been identified by Mr. Dertzbaugh and testified to by him as having been prepared from facts within his own knowledge and from his having charge of the company's banking arrangements, as follows:

Exhibit in evidence

Corporate bank loans personally guaranteed by J. K. Robinson, jr., president, and Alfred McEwen, treasurer

Year	Bank loans, notes payable guaranteed
1908	$27,000.00
1909	87,000.00
1910	68,250.00
1911	68,250.00
1912	84,949.25
1913	82,700.00
1914	98,050.00
1915	113,859.01
1916	92,550.00
1917	60,890.00
1918	57,890.00
1919	52,000.00
1920	15,000.00
1921	15,000.00

Counsel for respondent objected to the admission of said statement on the ground that it was immaterial and incompetent and was very remote evidence of the value of services of those persons to the corporation in question. Counsel for petitioner stated that it was material to show the type of service rendered; that the services were out of the course of normal and usual services rendered by officers; that it was one of the circumstances connected with their service; that these men were not financing their own enterprise, since they held less than 50% of the stock, the board member ruled as follows:

"The MEMBER. That is true, as you say, under certain circumstances, but it was not an incident to the employment, and the corporation would be indebted to them morally for those services in a certain way, but I do not see that that is the basis for greater compensation to any officer or employee. If that came in under regular services as these past exhibits seem to indicate, I can see the force of that, but I can not see the force of endorsing paper here as a service to the corporation for which a salary should be paid. I think I will sustain the objection to this offer.

* * * * * * *

"The MEMBER. I do not doubt but what that was a great benefit to the corporation, and my view of it is that it is not such service that calls for salary or remuneration in that way. That is the way I view it."

During the year 1920, and the years prior thereto, the company had been unusually successful.

Thereupon Mr. Crawford testified as follows:

38 Q. When do you recall the first time the question of additional compensation of these two men was brought to your attention?

A. I should say it came up off and on, about the summer of the preceding year, but never for action. It was discussed.

Q. Well, how did it come up?

A. It would come up at meetings when we were having board meetings; it would come up and be talked about and dropped. No motions were made and no actions were taken on it.

Q. What was the general discussion with respect to the allowance or nonallowance of additional compenation?

Mr. FISHER. I object to that as incompetent and immaterial. No action was taken, and no liability was accrued, and no final decision reached.

The MEMBER. You can not change the minutes.

Mr. SUTTER. We are not trying to do that, if your honor please.

The MEMBER. What is the purpose of it?

Mr. SUTTER. I am trying to show, if the court please, that it was recognized for five or six months prior to this that these men were entitled to additional compensation.

The MEMBER. He testified it was talked about. Now, he is asked to go into that conversation, or that talk. I think it is objectionable. The minutes speak for themselves as the last action, and the objection is sustained.

Mr. SUTTER. An exception, if your honor please.

The MEMBER. An exception may be noted.

In the year 1920 the factory had lost its heaviest technical adviser, to wit, Mr. Crawford, who left in 1917.

In the months immediately prior to May 7, 1920, Mr. Robinson and Mr. McEwen both rendered special services to the corporation. That year was a very busy year for both Mr. Robinson and Mr. McEwen, and they had negotiations up with two big plants that wished to sell out, one of them going so far as to make an offer to the Ox Fibre Brush Company to take over the management if it would do so without its paying anything. This was the Brommel Brush & Fibre Industry, located in Cincinnati. The negotiations were dropped in the middle or latter part of April, 1920. It was necessary for Mr. McEwen and Mr. Robinson to travel considerably in connection with these negotiations. They visited the plants in Cincinnati and did other work of that sort relating to the negotiations necessitated in considering this proposition.

39

A special meeting of the board of directors of the Ox Fibre Brush Company was held in New York on May 6, 1920. Mr. Crawford was elected to preside at that meeting. All the directors, except Emory L. Coblentz, were present. The stock of the company consisted of 9,000 shares. Of this, Mr. J. K. Robinson, jr., owned

about 1,850 shares, and, including the shares held by his wife and children, a total of about 1,600 shares; Mr. McEwen owned about 100 shares, and, including the shares held by his wife and children, a total of about 1,750 shares. At this meeting there were two main subjects up for consideration; one of them was the increased remuneration to the two chief executive officers of the company, and the other was the matter of declaring special dividends. Motions were made and carried, as appear in the minute book to authorize additional compensation to Mr. J. K. Robinson, jr., the president, and Alfred McEwen, the treasurer.

There were no adverse votes with respect to the additional compensation, nor was there any adverse discussion; the meeting was absolutely unanimous and in harmony.

Emory L. Coblentz, the director who was not present, resides at Frederick, Maryland. He is a banker and stockholder to the extent of 5% in 1920, in the Central Trust Company of Frederick, Maryland, and had been with said company since 1908. Prior to that time, he had some connection with other banks. Mr. Coblentz is also a practicing attorney, but does very little practicing. He is a director of the Valley Savings Bank of Middletown; vice president and director of the Union Manufacturing Company, of Frederick, Maryland; a director of the Economy Sale & Manufacturing Company, of Frederick; resident and director of the Frederick Hotel Company, which owns the Francis Scott Key Hotel in Frederick, and also an officer and director of other companies. For more than ten years he has been director of Ox Fibre Brush Company.

40 Mr. Coblentz was informed by notice and by personal communication from Mr. Dertzbaugh, the general manager of the company, of the purpose of the meeting. Being unable to attend, he wrote a letter to the secretary to be read at that meeting, which set forth his position on the question before the board of directors, as follows:

Exhibit in evidence

MAY 3RD, 1920.

WILLIAM A. EVANS, Esq.,
Secretary Ox Fibre Brush Comuany,
Guaranty Trust Building,
44th Street and 5th Avenue, New York.

MY DEAR SIR: Replying to your letter of the 30th ultimo, advising me of a special meeting of the board of directors of the Ox Fibre Brush Company to be held on Thursday, May 6th, at 9.30 a. m., I beg to advise that I have an appointment in Frederick on the evening of May 5th which I can not now cancel, and hence it will be impossible for me to reach New York in time for this meeting.

Mr. Dertzbaugh has explained to me that the purpose of this meeting is to consider and act upon a proposition for the granting of additional compensation amounting to $25,000 each to Mr. Robin-

son and Mr. McEwen for their past services to the company. I have so much confidence in the fairness of these two gentlemen in the management of the property and of their interest in all the stockholders that I feel they would make no proposition which was not thoroughly considered by them as being fair and equitable, and if I were present at this meeting I would gladly vote for such proposition for additional compensation as they think under all the circumstances is fair and equitable to all the parties interested.

Yours very truly,

_____ _____.

In voting the amount of $24,000 as additional compensation for each of these men, one of the directors, Mr. Crawford, expressed their reasons as follows:

41 "When we took into consideration the services of the men in question, what they had been doing, what the company was when they took it over, what its financial condition was, what its standing was in the art, and then saw how the money we had invested was beginning to bring us in a very substantial return, and how the company had risen to the foremost rank in the business world of brush making; when we saw that we had just received a 50 per cent stock dividend on our stock, we thought that anything less than $24,000 would have been absolutely inadequate, and, besides, we had another object in view: We thought the best way to continue the prosperity that we had enjoyed was to make it worth these men's while to give us the same type of service. We also had one other matter in mind, that we could not get anything like the type and quality of service that the company was getting from these two men at the time, and if we went out into the open market to buy that we would have had to pay far more than their drawing account and the salary accounts of these two men represented."

On cross-examination, Mr. Crawford testified as follows:

Q. Did you make any personal investigation of what it might cost to employ others to come in?

A. I am perfectly familiar with that situation. I have been a factory executive in a rather large way for a good many years, and I know what the market value for such services are fairly well.

Q. Well, they paid this $24,000 out for 1920 over and above the fixed compensation of $12,000 in one case and $15,000 in the other?

A. Yes.

Q. You considered that fair and reasonable as compensation to equalize—proper compensation for services of the kind and character that they rendered?

A. May I answer that question in this way: I considered that if we had to go in the open market and hire that kind of services we would have had to pay $30,000 to $50,000 a year. Those men at that

time were not only taking care of the services of treasurer and president, they were handling all of the large purchases of our company, and they were directing the hiring of the personnel, as you
42 see, by the fact that they hired me. They were directing the policy of the company, and even directing the lines along which factory development should go. They were doing the work of probably five men in addition to the executive duties of president and treasurer.

Officers' salaries, gross sales, amounts carried to surplus after deducting officers' salaries and other expenses, dividends declared and paid, and the amount of capital stock outstanding for the years 1908 to 1914, inclusive, and 1918 to 1922, inclusive, were as follows:

	Officers' salaries	Gross sales	Net earnings, amount carried to surplus	Dividends declared and paid	Outstanding capital stock
1908	$6,000.00	Not shown.	$3,972.44	None.	$300,000
1909	6,000.00	$374,236.66	41,985.36	None.	275,000
1910	9,999.00	467,943.50	68,069.99	$8,686.50	288,000
1911	9,999.00	521,650.78	21,611.75	4,500.00	208,000
1912	9,999.00	596,010.57	52,012.74	4,500.00	300,000
1913	10,999.00	612,087.57	49,810.44	13,387.50	297,500
1914	16,000.00	596,856.83	28,591.95	4,462.50	297,500
No data furnished for 1915 to 1917.					
1918	25,384.64	1,068,641.46	132,679.16	56,576.00	483,400
1919	27,000.00	1,193,742.39	211,130.82	133,579.50	474,700
1920	75,000.00	1,273,474.72	158,753.67	(123,275.00 (300,000.00	Cash. Stock.
1921	27,000.00	980,376.56	128,745.07	94,388.00	900,000
1922	33,000.00	1,342,834.03	255,762.16	170,860.00	900,000

The officers' salaries, gross sales, net income before deducting officers' salaries, amounts carried to surplus after payment of salaries and other expenses, dividends declared and paid, and the amount of the capital stock outstanding for the year 1920 were as follows:

43

Officers' salaries (Pet. Ex. 2)	Gross sales (Pet. Ex. 2)	Net income before officers' salaries (Pet. Ex. 2 and 3)	Net earnings, amount carried to surplus (Pet. Ex. 3)	Dividends declared and paid (Pet. Ex. 4)	Outstanding capital stock (Pet. Ex. 1)
1920					
$75.00	$1,273,474.72	$233,753.67	$158,753.67	$123,275 (50% stock, $300,000)	$477,500

The percentage of officer's salaries to gross income, to net income before deducting salaries, and the percentage of net income after paying salaries and other expenses to the outstanding capital stock for the year 1920 were as follows:

	Officers' salaries to gross income (Pet. Ex. 2)	Officers' salaries to net income before deducting salaries (Pet. Ex. 2 and 3)	Net income after salaries to outstanding capital stock (Pet. Ex. 3)
1920	5.8%	32.09%	33.24%

As a stockholder and director of the company in 1920, Mr. Crawford did not feel that any part of the earnings attributable to his stock was being distributed to these men. That point was perfectly clear in the minds of the directors. They were simply handling the legitimate expenses of conducting the operations of the company. It was a matter of salary for services which were being rendered.

There was no adverse feeling expressed to the right of the officers to additional compensation in May, 1920, and the directors seemed to be quite willing to reward them for their good efforts, as they expressed it, that had been given by these officers to the business. The record of the company was opened and the history of the company considered by the directors. There was a discussion of the showing that had been made and the good work that had been done, and the directors thought the officers were entitled to compen-
44 station for the splendid way in which the company had been dragged from red figures into a very profitable investment for the stockholders.

After the meeting of the board of directors, at which it was resolved that additional compensation of $24,000 should be paid to J. K. Robinson and a like amount to Alfred McEwen, Mr. Dertzbaugh, who kept the books of the company and was general manager, received a signed copy of the resolution and made an entry on the books of the company, in May, 1920, charging profit and loss and expenses and crediting the personal accounts of Mr. Robinson and Mr. McEwen with $24,000 each. The total of $48,000, representing the extra compensation authorized by the minutes, was deducted from gross income of the corporation in computing the taxable net income for the year 1920 on its income and profits tax return, but this deduction was disallowed in an audit of the return by the Commissioner of Internal Revenue. The books of the corporation were kept on the accrual basis.

The respondent called no witnesses in rebuttal.

Thereupon counsel for both petitioner and respondent stated that they had no further or other evidence to present and rested the case.

The petitioner, Ox Fibre Brush Company, tenders and presents the foregoing as its statement of evidence in this case, all parts not essential to the decision of the questions presented by the petition for review being omitted, and prays that the same be approved by the

United States Board of Tax Appeals and made a part of the record in this cause.

R. S. DOYLE,
CHARLES D. HAMEL,
HARRY B. SUTTER,
Attorneys for Petitioner

Order settling statement of evidence

I hereby certify that the foregoing statement of evidence has been examined by me and found conformable to the truth, and contains all the evidence in the case, in narrative form, deemed essential to the decision of the question presented by the petitioner for review.

45 Where the testimony herein is set forth in the form of questions and answers, it is so set forth that the evidence might be clearly understood.

Each of the exceptions stated to have been taken by the attorney for the petitioner were so taken and were duly allowed and noted by the board, and in order that each and every one may be preserved and made of record this statement of the evidence is duly approved and signed and ordered to be made of record in the above-entitled cause this 14th day of May, 1928.

W. D. LOVE,
Member United States Board of Tax Appeals.

Before United States Board of Tax Appeals

OX FIBRE BRUSH COMPANY, PETITIONER
v.
DAVID H. BLAIR, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT
} Docket No. 8153

Agreement to Statement of Evidence Under Equity Rule 75

We have examined and read the foregoing 20 pages comprising all the evidence taken in the case of Ox Fibre Brush Company, petitioner v. David H. Blair, Commissioner of Internal Revenue, respondent, Docket No. 8153, in the United States Board of Tax Appeals, said evidence being stated in simple and condensed form, all parts not essential to the decision of the questions presented by the petition for review being omitted and the testimony of witnesses being stated in narrative form. And we agree that all parties hereto have received due and legal notice of said statement as required by Equity Rule No. 75, and we accept service of such notice and hereby waive further notice of the filing of the statement, and we agree that said statement as made may be approved by the board member hearing the case, without further notice to any party hereto, and that when so approved may be filed in the clerk's office and

become a part of the record for the purpose of the petition for review in said cause filed by Ox Fibre Brush Company, petitioner.

C. M. CHAREST,
Attorney for Respondent.

46 [Certificate to foregoing paper omitted in printing.]

Filed May 12, 1928

Before United States Board of Tax Appeals

OX FIBRE BRUSH COMPANY, PETITIONER
v.
DAVID H. BLAIR, COMMISSIONER OF INTERNAL REVENUE, respondent } Docket No. 8153

Præcipe for Transcript of record

TO THE CLERK OF THE UNITED STATES BOARD OF TAX APPEALS:

You will please prepare a transcript of record in this cause, and on or before May 26, 1928, transmit the same to the clerk of the United States Circuit Court of Appeals for the Fourth Circuit, and include in said transcript copies duly certified as correct of the following documents:

1. The docket entries of proceedings before the board in the above above entitled cause;
2. Pleadings before the board;
3. Findings of fact, opinion, and decision of the board;
4. Amended petition for review;
5. Statement of evidence as agreed upon.

Said transcript to be prepared as required by law and the rules of the United States Circuit Court of Appeals for the Fourth Circuit.

47-48 AGREEMENT TO PRÆCIPE

We hereby agree that the above and foregoing præcipe is correct; that the records, documents, papers, and proceedings therein set forth are sufficient for a complete record in this cause on appeal, and we hereby adopt the foregoing as a list designated by each of the parties to this cause to complete said transcript, and we hereby waive the issuance and service of notice upon any party hereto, and agree that said præcipe shall be obeyed by, and acted upon by, the clerk as fully and to all intents and purposes in the same manner as if said præcipe had been regularly filed and a true copy thereof served upon each party hereto.

R. S. DOYLE,
CHARLES D. HAMEL,
HARRY B. SUTTER,
Attorneys for Petitioner.
C. M. CHAREST,
Attorney for Respondent.

[Certificate to foregoing paper omitted in printing.]

49 In United States Circuit Court of Appeals for the Fourth Circuit

No. 2753

OX FIBRE BRUSH COMPANY, PETITIONER
versus
DAVID H. BLAIR, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On petition to review the decision of the United States Board of Tax Appeals

Minute entries

May 22, 1928, the transcript of record is filed and the cause docketed.

Same day, the appearance of Richard S. Doyle, Harry B. Sutter, and John Enrietto is entered for the petitioner.

Same day, the appearance of Mabel Walker Willebrandt, Assistant Attorney General, C. M. Charest, general counsel, Bureau of Internal, and L. M. Scott, special attorney, Bureau of Internal Revenue, is entered for the respondent.

July 5, 1928, twenty-five copies of the printed record are filed.

August 2, 1928, stipulation of attorneys as to the time for the filing of their respective briefs is filed.

50 September 27, 1928, the appearance of Morton P. Fisher, special assistant to the Attorney General, and Dorothy A. Moncure, attorney, is entered for the respondent.

Same day, stipulation of attorneys as to the time for the filing of respondent's brief and petitioner's reply brief is filed.

Argument of cause

November 13, 1928 (October term, 1928), cause came on to be heard before Parker and Northcott, Circuit Judges, and Coleman, District Judge, and is argued by counsel and submitted.

51 In United States Circuit Court of Appeals, Fourth Circuit

[Title omitted.]

(Argued November 13, 1928. Decided April 9, 1929)

Before PARKER and NORTHCOTT, Circuit Judges, and COLEMAN, District Judge.

Opinion

Filed April 9, 1929

52 COLEMAN, District Judge:

This is an appeal for review of a decision of the United States Board of Tax Appeals affirming the finding of the Commi

sioner of Internal Revenue that there was a deficiency of $24,091.60 in the income and profits tax for the calendar year 1920, paid by the petitioner, the Ox Fibre Brush Company, hereinafter called the company. The deficiency as claimed arose from the fact that the company had deducted from its net income the sum of $48,000.00, one-half of which having been voted in 1920 to the company's president as "extra compensation for his past services" and a like sum, by similar resolution, to the company's treasurer. The company claimed the right to make this deduction by virtue of section 234 (a) (1) of the revenue act of 1918 (40 Stat. 1057), which is as follows: "That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

"(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered * * *."

The material facts as disclosed by the evidence are as follows: The company, a West Virginia corporation, during the year 1920 and for many years prior thereto, had been engaged in the manufacture of brushes, its factory being located at Frederick, Maryland, with executive offices and sales headquarters in New York City and branch sales offices in St. Louis, Cincinnati, Philadelphia, and Boston. Mr. Robinson, the company's president during the year 1920, had served the company in this same capacity since 1906, and
53 Mr. McEwen, the treasurer in 1920, had held the same office since 1907. Both of these officers had devoted their entire time to the company's interests since 1907. Each year they had personally guaranteed bank loans of considerable size made to the company. Prior to 1917, a technical expert had managed the company's plant, for which he received $10,000 per annum, but in that year the president and treasurer assumed general management of the plant. The services of the technical expert were dispensed with, and in his place a factory superintendent was employed at a much lower salary. In addition to their regular executive duties, the president and treasurer handled all large purchases, directed all sales, the hiring of personnel, and also directed the general policies of the company. Prior to Mr. Robinson's and Mr. McEwen's administration of the business, it had been in a chaotic state and operated at a loss, but under their direction and control the gross sales of the company increased from $374,236.66 in 1909 to $1,273,474.72 in 1920; the net income increased from an operating loss of $3,972.44 in 1908 to net earnings, after deduction of salaries including the amounts here in question, of $158,753.67 in 1920. No dividends were paid until 1910, but were increased from $4,500 in 1911 and 1912 to $423,275 in 1920, represented by 50% stock dividend of $300,000 and cash dividends aggregating $123,275 or 25.98%, on the outstanding capitalization at the beginning of that year—that is to say, under the new management, the company advanced from the status of a poor competitor

with other corporations employing contract prison labor in the manufacture of brushes to a leading place in the brush trade. The percentage of officers' salaries to gross income for 1920 was 5.8%. The percentage of officers' salaries to net income, before deducting salaries, was 32.08%, and the percentage of net income, after paying salaries and all other expenses, to outstanding capital stock
54 was 33.44%. The net income in 1920—namely, $158,753.67, after deduction of all expenses including officers' salaries, represented a return of 21.13% on invested capital of $751,038.31, as determined by the Commissioner of Internal Revenue for that year. As a result of the bureau's disallowance of the $48,000 here in question, the taxable net income for 1920 of the company was $206,753.67, or a return of 27.53% on invested capital and surplus.

In 1919 and 1920, $12,000 and $15,000 had been paid as salaries to the president and treasurer, respectively. In 1918 their combined salaries were approximately $25,000. The record does not disclose what they received in 1915, 1916, and 1917, but in 1914 they together received $16,000; in 1913, $11,000; in the three preceding years, $10,000, before which they received $6,000. On May 6th, 1920, the board of directors at a meeting duly called unanimously voted to pay each of these officers additional compensation of $24,000. The following appears from the minutes of this meeting:

"This meeting having been specially called for the purpose of considering and acting upon the proposal for a grant of additional compensation to Mr. J. K. Robinson, jr., and to Mr. Alfred McEwen, for their past services to the company, * * *

"Resolved that this board hereby authorize and direct the payment of the sum of twenty-four thousand ($24,000) dollars to Mr. J. K. Robinson, jr., as extra compensation for his past services to this company as an officer thereof and in any other capacity, the same to be paid when, in the discretion of the officers, funds of this corporation for this purpose are available.

Resolved that this board authorizes and directs the payment of the sum of twenty-four thousand ($24,000) dollars to Mr. Alfred McEwen as extra compensation for his past services to this company as an officer thereof and in any other capacity, the same to be paid when in the discretion of the officers funds of this corporation for this purpose are available."

55 The petitioner's books were kept on an accrual basis, and during the month of May, 1920, proper entry was made therein, crediting the accounts of the president and the treasurer with the additional compensation voted, as aforesaid, and charging the expense accounts therewith.

The president and treasurer and their immediate families owned approximately 36% of the stock of the company. The remaining stock was mostly owned by the company's employees.

On this evidence the Board of Tax Appeals found, first, that the additional compensation voted to the company's president and

treasurer in 1920 was intended to be as and for, and was as and for, salaries for the year 1920; second, that the action of the company's board of directors in so voting did not raise a presumption that the extra compensation was in fact reasonable for services actually rendered; and third, that such extra compensation was in excess of reasonable compensation for services performed in 1920 on the ground that the duties performed were not materially different from those performed in preceding or succeeding years for which the compensation received was, the board asserted, not shown to have been inadequate, although it was conceded that the officers were efficient and brought prosperity to the company and that the additional compensation was a merited recognition by the company of their valuable services rendered prior to 1920. There are fourteen assignments of error, which, summarized, question all three of these findings. We will consider these findings in the order stated.

First, to say that the additional compensation voted to the company's president and treasurer in 1920 was intended to be as and for, and was as and for, salaries for the year 1920, is to torture the very language of the resolutions themselves. The payment to each officer is expressly stated to be "extra compensation for his
56 past services," not merely measured by such services. The wording could scarcely be clearer. Whether, if the resolution had been differently worded—for example, if the extra compensation had been voted "to make up for lack of same in past years"—the present finding of the Board of Tax Appeals on this point might have been justified; it is not necessary for us to decide. See Vaughn & Barnes, Inc., 6 B. T. A. 1279. Therefore, this first conclusion of the board we find to be erroneous and not binding. While the board's findings of primary facts are conclusive, the court must inquire into other facts in order correctly to determine whether the board's conclusion is supported by the evidence—namely, whether it is in accordance with law. We find no evidence whatsoever to support this conclusion. The jurisdiction of this court to review decisions of the Board of Tax Appeals is conferred by the revenue act of 1926 (26 U. S. C. A. sec. 1226 (b)), which is as follows: "Upon such review, such courts [circuit courts of appeal] shall have power to affirm or, if the decision of the board is not in accordance with law, to modify or to reverse the decision of the board * * * as justice may require." As was said in Bishoff vs. Commissioner, 27 F. (2d) 91, 92;

"This provision is within the trend of recent legislation respecting fact-finding tribunals with special judicial powers, such as the Federal Trade Commission, whose 'findings of fact, if supported by testimony, are made conclusive (Comp. Stat. sec. 8836 a–k (15 U. S. C. A. secs. 41–51); Curtis Pub. Co. v. Federal Trade Commission [C. C. A.], 270 F. 881, 911), and is generally regarded, because of the power to modify or reverse such of the board's decisions as are 'not in accordance with law,' as conferring upon the designated

appellate courts jurisdiction to review not questions of fact, such as complicated accounts and disputed values, but only matters of law such as are raised by writ of error on review of a judgment
57 entered on the verdict of a jury. Avery v. Commissioner (C. C. A.), 22 F. (2d) 6; Brown v. Commissioner (C. C. A.), 22 F. (2d) 797. Even accepting as conclusive the board's findings of primary facts, it sometimes happens that the reviewing court must inquire, as on writ of error, into the ultimate fact finding in order correctly to determine whether the decision is validly supported by evidence and therefore is 'in accordance with law.'"

See also Royal Packing Co. vs. Commisisoner, 22 F. (2d) 536.

Turning to the Board of Tax Appeals' second conclusion we are likewise forced to declare that to be erroneous. The action of the board of directors of a corporation in voting salaries for any given period is entitled to the presumption that such salaries are reasonable and proper. This presumption, however, is not conclusive. Becker Bros. vs. United States, 7 F. (2d) 3. In other words, the payment of large salaries to officers may well prompt an inquiry into the question whether the amounts paid as salary are such in fact, rather than a distribution of profits in the guise of salary. The statute imposes two requirements: First, that the proposed allowance shall be a necessary expense, and second, that it shall be reasonable. If the allowance has no substantial relation to the measure of officers' services and is utterly disproportionate to their value, it is not in reality payment for services and so can not be regarded as "ordinary and necessary expenses." See Botany Worsted Mills vs. United States, decided by the Supreme Court January 2nd, 1929; United States vs. Philadelphia Knitting Mills Co., 273 Fed. 657. Likewise, the allowance is not to be permitted if and to the extent that as compensation it is relatively unreasonable, even though not of such an extraordinary, unusual, or extravagant amount as to condemn it entirely as in no sense compensation for services. The prima facie presumption in favor of the action which a corporation has taken in cases of this kind has repeatedly been recognized by
58 the Board of Tax Appeals itself. For example see Collins, McCarthy Candy Co. vs. Commisisoner, 4 B. T. A. 1280; Standard Silk Dyeing Co. vs. Commissioner, 9 B. T. A. 648. This presumption is in no wise inconsistent with the principle that the burden of proof rests upon the taxpayer. W. K. Henderson Iron Works & Supply Co. vs. Blair, 25 F. (2d) 538, and cases cited. The taxpayer in the present case has, we think, fully sustained the burden of proof for the reasons hereinafter explained.

It follows from what has been said that it is unnecessary to pass upon the correctness of the board's third conclusion—namely, that the extra compensation was in excess of reasonable compensation for services performed in 1920, except in so far as such determination may assist in deciding whether the present deductions are reasonable for past years; but it becomes necessary first to decide whether deductions for past years are permissible under the statute.

It is our conclusion that such deductions are permissible. The language of the statute with respect to allowable deductions is "all

the ordinary and necessary expenses *paid or incurred* during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services *actually rendered.*" (Italics inserted.) The statute does not limit its application to services rendered within the taxable year. The test of deductibility lies in the answer to the question: In what year has a fixed liability for the payment arisen? Only for such year is the payment deductible, and, therefore, it is not to be allocated over other years in which the services may have been rendered. This is quite different from saying that, where, as here, books are kept on the accrual basis the deduction may not include compensation, fixed or paid in the taxable year, for services rendered in prior years.

In defining the terms "paid or incurred" and "paid or accrued" the act (sec. 200) merely says that they "shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212"—that is, on the cash or the accrual basis or by such other method as clearly reflects the income. But a salary can neither be "incurred" nor can it have "accrued" until the payor's liability for the same has been fixed—that is, until the company, in the present case, has voted it payable. For this reason, expenses of this kind are not to be confused with taxes, and therefore such decisions as *United States* vs. *Anderson*, 269 U. S. 422, upon which the Government relies, are not controlling. In that case the Supreme Court held that the tax imposed by the munitions tax act of 1916 was a proper accrual and was deductible for 1916, though it was not required to be paid until 1917 where all the events which *fixed* the amount of the tax and *determined the liability* occurred in 1916, since the gross income for 1916 could not have been determined without deducting therefrom the reserve set up for the munitions tax as a part of the total cost and expense attributable to the production of income for that year.

As for the case of *Illinois Central, etc., R. R.* vs. *Interstate Commerce Commission*, 206 U. S. 441, which the Government has also stressed in support of its contention, merely to state what the court there held—that "instrumentalities which are to be used for years should not be paid for by revenues of a day or year" (p. 463)—is to refute completely its application to the present facts. Current salaries are not capital investments. We are not unmindful of the fact that the Seventh Circuit, in *W. S. Bogle & Co.* vs. *Commissioner*, 26 F. (2d) 771, in construing a similar provision of the income tax act of 1916, held that the Board of Tax Appeals properly refused to allow a deduction for salary payment made to a corporation's president as compensation for previous years, saying (page 772): "This statute was intended to allow ordinary and necessary expenses paid and incurred within the year for officers' salaries. Where a salary has been fixed and fully paid for one year, it can not be increased in some later year (when profits are larger) and the increase deducted from the net profits of the prosperous year." Prima facie, this statement would appear to be in conflict with the principle that we here announce, but it may not be so intended, because it is to be noted that the court speaks of a salary "fixed and

fully paid" for a previous year, implying, as it would seem, that the additional compensation rendered the total salary unreasonable and excessive. At least the opinion is so phrased as to leave room for doubt on this point.

So also the case of W. K. Henderson Iron Works & Supply Co. vs. Blair, supra (Court of Appeals, District of Columbia), decided merely that a salary voted in one year for services performed in a preceding year and disallowed as a deduction for such preceding year is likewise not allowable for the year in which voted in the absence of proof to sustain its reasonableness.

That the practice here sanctioned may be subject to abuse is not sufficient to condemn it. Whether there is actual abuse becomes a question of fact in each case. A corporation with a large surplus in a given year may attempt to dispose of that surplus in the guise of salaries and thereby evade its full tax burden, but there is no evidence that such occurred in the present case; nor is there any bad faith to be deduced from the fact that these officers, together with their families, owned approximately 36% of the company's stock. The additional compensation was voted to them not because they were stockholders, but because they performed services as employees of the corporation which its board of directors believed to have been peculiarly valuable. If rigid rules of accounting are allowed to supplant that reasonable amount of flexibility which must, from the very nature of things, go hand in hand with the vicissi-
61 tudes of business, loyalty, and ambition on the part of employees will become deadened, and those persons whose services are essential to the success of a given enterprise will be unavailable at the very time when they are most needed. For a corporation to defer payment of full compensation to its employees in times of stress is no different in principle from the deferring of any of its other obligations. Both must be met in due course. Tax laws should aim to encourage, not to oppose this result, and should be so construed unless clearly expressive of a contrary intent.

In the present case the fact that the prior years are not specifically designated is not material, because evidence as to which years were referred to is not lacking. In 1917, through the reorganization which the president and treasurer had brought about, the company was put upon a paying basis and from then on the business became increasingly successful. In that year they took over the general management of the factory, and in addition to their regular executive duties handled all large purchases, directed all sales, the hiring of the personnel, and all questions of general policy. It further appears that shortly prior to May 7th, 1920, when the resolutions in question were passed, these officers had rendered special services to the corporation looking toward a possible merger with other companies, and at about this time the question of additional compensation was broached, but definite action thereon was postponed.

The Government appears to rely upon the fact that the corporation's books were kept on an accrual basis and not on a receipts and disbursements basis. It argues (referring to section 212 (b) of the act of 1918) that the accrual basis having been adopted, it must be consistently followed in a manner which clearly reflects income, and that expenses can only be deducted in the year to which they are attributable. With this statement we entirely agree, but the
62 method of bookkeeping makes no difference in the present situation. "To incur" means "to become liable or subject to." While an obligation that has accrued may also be said to be synonymous with one that has been incurred, the fact remains that there would have been no authority to enter the salaries in the present case as accrued until they had been voted or fixed. Under the accrual system, an expense accrues when all events have occurred from which liability is determined and has become fixed, even though payment be not yet due. That is to say, the basic idea is that the books shall immediately reflect obligations and expenses definitely incurred, and income definitely earned, without regard to whether payment has been made or is due. This was the theory upon which the case of United States vs. Anderson, supra, was decided. Thus, when in the present case the Government argues that if a resolution, authorizing additional compensation, be passed subsequent to the year in which the services to be compensated were rendered, the corporation must allocate the payment to the proper years and file amended returns for those years claiming the deduction in the amended return, it misconceives the basic idea of the accrual plan.

The principle has been clearly stated by the Board of Tax Appeals in a number of cases. For example, in the appeal of Vander Kamp Holland Dutch Bakers, 2 B. T. A. 1247, the board rightly held that additional compensation voted to a company's officers in 1920 for 1919 services was not deductible from 1919 income, saying (p. 1251): "It remains to determine in what year the deduction is to be allowed. Was the obligation incurred in the year when the services were rendered or was it incurred when the additional compensation was voted? Until it was voted, there was nothing more than a moral obligation; there was no legal obligation which could be enforced. We must accordingly hold that the $7,000 of additional compensation, voted in 1920 for services rendered in 1919,
63 was an obligation incurred in 1920 and is deductible in that year and not in 1919." To the same effect see appeal of Arter Paint & Glass Co., 2 B. T. A. 1256; appeal of Randall Bros. Inc., 4 B. T. A. 291; Roubaix Mills Inc., 7 B. T. A. 877. Relying upon these and similar decisions, the Bureau of Internal Revenue, in 1927, adopted regulations in conformity with what was there said. General Counsel's Memorandum 941, Internal Revenue Cumulative Bulletin, Vol. VI, No. 1, page 205 (1927). We are unable to reconcile the above-mentioned decisions of the board and the ruling of

the bureau with other decisions of the board, or with the position which it has taken in the present case.

We now come to the final question to be decided, namely, whether the additional salaries were reasonable compensation for services rendered prior to 1920. The board in its opinion states that "there is nothing in the record to indicate that additional salaries might be expected or would be granted in the future, and there is nothing to indicate that the duties performed were materially different from those performed in the preceding or succeeding years. It is not intimated that the compensation received prior to 1920 was inadequate. Under these circumstances we are of the opinion that the salaries paid by the petitioner to its officers in years prior to and subsequent to 1920 is the best evidence of their reasonableness and their value to the petitioner in that year." We have already shown the error into which the board fell in considering the additional compensation from the aspect of its reasonableness as salary payments for the year 1920. We have also pointed out that the evidence clearly indicates that the duties performed by the president and treasurer were materially different in the three years prior to, as well as in 1920, from what they had previously been; and also that there was very definite intimation in 1919 that these officers were entitled to
64 recognition for the part which they had played in making the business so successful. So from no angle can we accept the aforesaid finding of the board as properly reflecting the evidence in the case. If, as appears, during the years 1917, 1918, and 1919, the duties of both the president and treasurer were doubled, and satisfactorily performed, is it reasonable to conclude that each were not entitled for services in each of these years to an additional compensation of $8,000—that is, to one-third of $24,000 voted to each in 1920, or that, a fortiori, these allowances would not have been reasonable if prorated over a greater number of years? We think not, especially in view of the fact that salaries generally were being advanced during this period, because of the very radical advance in the cost of living. The company's board of directors unanimously declared in good faith that the services rendered were worth the additional compensation. Such action, as we have seen, raises a presumption of reasonableness, which has not been overcome. No testimony whatever was offered on behalf of the commissioner in rebuttal.

The gross income of the company in 1918 and 1919, as well as in 1920, exceeded $1,000,000. Adopting, merely for the sake of illustration, the theory of the board of tax appeals that the additional allowances were for services in 1920, the total salaries paid to these officers in that year were $75,000, or less than 6% of the gross income. After deduction of these salaries and all other expenses, the return to stockholders exceeded 33%. While, of course, each case must be determined upon its own peculiar facts, these percentages obviously do not reflect any impropriety in the allowances in question. See United States vs. Reitmeyer, 11 F. (2d) 248; Wood &

Ewer Co. vs. Ham, 14 F. (2d) 995. This being true, when we divide and distribute these allowances equally over a period of three or more years, and add them to the salaries paid during those
65-66 years, there is no ground for argument that for services in any of those years the remuneration has been unreasonable.

In view of what we have said it becomes unnecessary to consider the relation of officers' salaries to outstanding capital stock for the year 1920. Nor is what the corporation did in the matter of salaries subsequent to 1920 pertinent to the present inquiry. The fact that the additional compensation was voted to the president and treasurer, respectively, as officers of the company "and in any other capacity," does not, we think, create any just ground for questioning the good faith or reasonableness of the corporate action, especially in view of the admittedly multifarious duties which the two officers performed in rehabilitating the business.

In view of our conclusions, it becomes unnecessary to consider those assignments of error which relate to the exclusion of certain evidence favorable to the company's contention.

The decision of the Board of Tax Appeals not being in accordance with law, because not supported by the evidence, is therefore reversed.

67 IN UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT

No. 2753

OX FIBRE BRUSH COMPANY, PETITIONER,

vs.

DAVID H. BLAIR, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On petition to review the decision of the United States Board of Tax Appeals

Judgment

Filed and entered April 16, 1929

This cause came on to be heard on the petition to review, and the transcript of the record of the proceedings of the said United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof it is now here ordered and adjudged by this court that the decision of the said United States Board of Tax Appeals in this case be, and the same is hereby, reversed, and that this case be, and the same is hereby, remanded to the said United States Board of Tax Appeals for further proceedings in accordance with the opinion of the court filed herein.

JOHN J. PARKER,
U. S. Circuit Judge.

APRIL 16th, 1929.

68 In United States Circuit Court of Appeals

Order staying mandate

Filed May 7, 1929

Upon the application of the respondent, by C. M. Charest, Esq., general counsel, Bureau of Internal Revenue, and for good cause shown,

It is ordered that the mandate of this court in the above case be, and the same is hereby, stayed pending the application of the respondent in the Supreme Court of the United States for a writ of certiorari to this court, unless otherwise ordered by this or the said Supreme Court, and provided said application is filed in the said Supreme Court within 30 days from this date.

May 7, 1929.

JOHN J. PARKER,
U. S. Circuit Judge.

In United States Circuit Court of Appeals

Order further staying mandate

Filed May 29, 1929

Upon the application of the respondent, by Mrs. Mabel W. Willebrandt, Assistant Attorney General, and Callom B. Jones, assistant U. S. attorney for the Eastern District of Virginia, and for good cause shown.

It is ordered that the mandate of this court in the above case be, and the same is hereby, further stayed pending the application of the respondent in the Supreme Court of the United States for a
69 writ of certiorari to this court, unless otherwise ordered by this or the said Supreme Court, and provided said application is filed in the said Supreme Court within 30 days from June 6, 1929.

May 29, 1929.

EDMUND WADDILL, JR.,
Senior Circuit Judge.

[Clerk's certificate to foregoing transcript omitted in printing.]

70 In United States Circuit Court of Appeals

Order substituting party respondent

On motion of counsel for the respondent, consented to by counsel for the petitioner, in the above case,

It is ordered that Robert H. Lucas, present Commissioner of Internal Revenue, be substituted as party respondent in place and stead of David H. Blair.

July 1, 1929.

JOHN J. PARKER,
U. S. Circuit Judge Presiding.

[Certificate to foregoing paper omitted in printing.]

71 Supreme Court of the United States

Order allowing certiorari

Filed October 21, 1929

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Indorsement on cover:] File No. 34,381. U. S. Circuit Court of Appeals, Fourth Circuit. Term No. 250. Robert H. Lucas, Commissioner of Internal Revenue, petitioner, vs. Ox Fibre Brush Company. Petition for writ of certiorari and exhibit thereto. Filed July 15, 1929. File No. 34,381.

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